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AFFIRMATIVE DEFENSES TO PRIMA FACIE VIOLATIONS OF THE ROBINSON-PATMAN ACT

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There are two basic defenses to a prima facie violation of section 2(a) of the Robinson-Patman Act.[1] The cost justification proviso of section 2(a) represents an attempt by Congress not to penalize efficiency. It allows the passing on of cost savings in the form of lower prices by the seller in the hope that they will be translated to all competitive levels and ultimately to the consumer. The cost proviso is probably a little more buyer oriented than seller oriented. If a seller makes a predetermined effort to price his product with relation to the cost factors involved and thereafter attempts to vary these prices with relation to various classifications in which he places his customers, he has a duty to make that known to all of his customers. This is necessary so that they can, by their ingenuity or by changes in their own methods of distribution, avail themselves of the different classifications being used by the seller and participate in the lower price.

The meeting competition defense of section 2(b)[2] is quite differently oriented. It allows the reaction of a seller in the face of a price raid by his competitors. The low price may come about for a variety of reasons, *e.g.*, better efficiencies on the part of one seller or a particular seller thinking he has a private preserve upon one market. All things being competitively equal, sometimes the very assertion of the meeting competition defense in any formal action raises a question as to which seller should have been sued in the first instance.

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1 Section 2(a) of the act outlines the elements of prima facie violation as follows:

> (a) It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them . . . .

Robinson-Patman Act § 2(a), 49 Stat. 1526 (1936), 15 U.S.C. § 13(a) (1964).

2 Section 2(b) provides:

> (b) Upon proof being made, at any hearing on a complaint under this section, that there has been discrimination in price or services or facilities furnished, the burden of rebutting the prima-facie case thus made by showing justification shall be upon the person charged with a violation of this section, and unless justification shall be affirmatively shown, the Commission is authorized to issue an order terminating the discrimination: *Provided, however,* That nothing herein contained shall prevent a seller rebutting the prima-facie case thus made by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor.

Robinson-Patman Act § 2(b), 49 Stat. 1526 (1936), 15 U.S.C. § 13(b) (1964).

I. Meeting Competition

In the old Clayton Act, the meeting competition defense was very broadly stated.[3] In the administration of the statute and in the cases brought under it, the defense proved to be a major obstacle to the effective enforcement of the statute. In 1936, the Robinson-Patman Amendment[4] attempted to close the loophole created by the broad interpretation of the meeting competition defense. The act provided that a seller could show that the lower price to one of his purchasers "was made in good faith to meet an equally low price of a competitor."[5] In its origins this defense was considered by many to be procedural, *i.e.,* one which could be asserted by the seller and accepted or rejected by the Commission or the courts, depending upon the competitive circumstances in which it arose. That view was rejected by the Supreme Court in the *Standard Oil* proceedings in which the Court held that the defense is not procedural but substantive and a complete defense to any charge of price discrimination.[6] Since 2(b) constitutes an absolute defense, the Commission and the courts must insist upon a very high standard of proof when the defense is offered. If they expand the areas of application of the 2(b) defense, they run the risk of defeating the very purpose for which the statute was enacted.

There are two elements which are necessary to establish the 2(b) defense successfully. First, the lower price must be given to *meet* an equally low price, and second, the price discrimination must be a defensive reaction to an individual competitive situation. The central inquiry to be made into any asserted 2(b) defense is whether the seller was acting in good faith. The burden is upon the seller to explain all of the circumstances surrounding the low price which it believes compel it to discriminate between its own customers as a matter of economic necessity.

Recently, the Commission has issued three opinions accepting the 2(b) defense. In the *Continental Baking* decision[7] the Commission said that the 2(b) defense is an *ad hoc* principle which has to be judged in the particular and peculiar circumstances of each case. The standard of good faith was defined as "simply the standard of the prudent businessman responding fairly to what he reasonably believes is a situation of competitive necessity."[8] Since this language is invitingly broad, perhaps a discussion of some of the circumstances in which the case arose is in order.

For several years Continental had been faced with price cuts by its competitors in favor of certain retail grocery stores. Its first reaction was to do nothing, but in the course of two years its market position deteriorated. Con-

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3 The original Clayton Act contained the following proviso:

> [N]othing herein contained shall prevent discrimination in price between purchasers of commodities . . . that makes only due allowance for difference in the cost of selling or transportation, or discrimination in price in the same or different communities made in good faith to meet competition. . . .

Clayton Act § 2, ch. 323, 38 Stat. 730 (1914).

4 49 Stat. 1526 (1936), 15 U.S.C. § 13 (1964).

5 Robinson-Patman Act § 2(b), 49 Stat. 1526 (1936), 15 U.S.C. § 13(b) (1964).

6 Standard Oil Co. v. FTC, 340 U.S. 231 (1951).

7 Continental Baking Co., 3 TRADE REG. REP. ¶ 16720 (F.T.C. Dec. 31, 1963).

8 *Id.* at 21646.

tinental investigated and discovered, with some degree of definiteness, who the competitors were that were offering the prices and what those prices were. Against that background Continental lowered its prices on an individual basis in order to retain its customers. The Commission found that the 2(b) defense had been made out. I hope that with a little education some of the difficulties with relation to the defense will be alleviated. They would certainly become so if the sellers were a little more careful about documenting the circumstances in which they felt they were compelled to lower their prices.

The *Ponca* case[9] also dealt with a unique situation. Ponca, a cigarette wholesaler, had granted discriminatory discounts to certain chain stores purchasing cigarettes bearing the New Mexico tax stamp. Although Ponca's prices to the chains were higher than those offered by cigarette manufacturers, the chains preferred to buy from Ponca since Ponca performed the stamping function. The testimony revealed that if Ponca had not quoted discriminatory lower prices, the chains would have purchased from the manufacturers at even lower prices and performed the stamping function themselves.[10] This assertion was borne out by later evidence which revealed that when Ponca ceased quoting discriminatory prices to the chains, the latter discontinued purchasing from Ponca and began to purchase from the manufacturers.[11] In the light of these circumstances the Commission sustained Ponca's 2(b) defense.

Beatrice Foods[12] is the most recent Commission decision sustaining the 2(b) defense. In *Beatrice,* respondent increased its discount to the Miller supermarket chain from 7 percent to 10 percent on its primary brand milk and to 12 percent on its private label milk. Testimonial and documentary evidence demonstrated that respondent had been apprised of the exact terms of an offer of higher discounts by a competitor (Fairmont) to the Miller chain prior to respondent's decision to grant discriminatory discounts. It further revealed that respondent had been advised by an official of the Miller chain that acceptance of the Fairmont offer would mean that respondent would no longer be serving the Miller account. On the basis of these facts, the Commission, Chairman Dixon dissenting and Commissioner MacIntyre not participating, concluded that respondent had made a good faith response to a legitimate competitive challenge. In his dissent, Chairman Dixon pointed out that the effect of the decision would be to allow discriminatory lower prices to continue for an indefinite period of time regardless of the continuance of the competitive challenge. In the Chairman's view, a seller asserting the 2(b) defense has a duty to verify the continuance of an equally low price offer of a competitor in order to establish good faith.

Chairman Dixon's opinion makes sense in a very practical way. Customers are injured by the continuation of individual discriminatory pricing which should be excused *only* upon a showing that the necessity for the preference is still in actual existence. The seller should have the obligation of looking into the situation periodically once it has discriminated to insure that its meeting competition defense is still valid.

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9 Ponca Wholesale Mercantile Co., 3 TRADE REG. REP. ¶ 16814 (F.T.C. Feb. 24, 1964).
10 *Id.* at 21788-89.
11 *Id.* at 21790.
12 Beatrice Foods Co., 3 TRADE REG. REP. ¶ 17311 (F.T.C. July 29, 1965).

In most of the recent Commission and court decisions respondents have failed to meet the strict standards of proof imposed on sellers asserting the 2(b) defense. In *Callaway Mills Co.,*[13] Callaway utilized a cumulative, annual volume discount schedule which resulted in higher net prices to certain purchasers and lower net prices to others. Callaway urged the 2(b) defense as justification for the lower net prices to the favored purchasers, but its defense was rejected by the Commission, Commissioner Elman dissenting.

First, it was apparent that Callaway's discriminatory pricing formula was universal in its application. Therefore, the discriminatory lower prices granted pursuant to that formula were not responsive to individual competitive situations, a requirement promulgated by the Supreme Court in the *Staley* case.[14] Parenthetically, it may be noted that this limitation on the 2(b) defense imposed by the *Staley* decision has been adopted by the Commission and the courts in cases involving section 2(d) of the amended Clayton Act. In *Exquisite Form Brassiere, Inc.,*[15] the Commission determined that Exquisite Form's cooperative advertising plan was generally operative and that the discriminatory advertising allowances paid pursuant to the plan were not designed to meet individual competitive situations; consequently, the 2(b) defense was rejected. The Commission's decision was affirmed by the Court of Appeals for the District of Columbia, which specifically observed that the limiting rule of the *Staley* case is applicable to advertising allowance discriminations violative of 2(d) as well as price discriminations in violation of 2(a).[16]

Second, in *Callaway,* the Commission held that the seller's failure to produce evidence that the goods on which they were granting lower prices were comparable in grade and quality to the goods being sold by competitors at equally low or lower prices necessarily precluded a finding that the seller had established the good faith defense.[17] In the Commission's view, such a showing is essential in order to determine whether a seller's lower prices were granted as a good faith response to the equally low price offers of competitors. For, as the Commission observed, if the goods on which Callaway granted lower prices were superior in grade and quality to the goods of competitors, Callaway, in effect, would be undercutting competitors' prices, and therefore not acting in good faith.[18] In the absence of such evidence in the *Callaway* case, the Commission was unable to determine whether Callaway had acted in good faith, and the 2(b) defense was rejected. The Commission employed similar reasoning in rejecting the 2(b) defense in a companion proceeding, *Cabin Crafts, Inc.,*[19] and in *Purolator Prods., Inc.*[20]

The reasoning of the Commission on this point is sound. Whether a product

13 *Sub nom.* Bigelow-Sanford Carpet Co., 3 Trade Reg. Rep. ¶ 16800 (F.T.C. Feb. 10, 1964).
14 FTC v. A. E. Staley Mfg. Co., 324 U.S. 746 (1945).
15 3 Trade Reg. Rep. ¶ 16753 (F.T.C. Jan. 20, 1964).
16 Exquisite Form Brassiere, Inc. v. FTC, 5 Trade Reg. Rep. (1965 Trade Cas.) ¶ 71491 (D.C. Cir. July 2, 1965).
17 *Sub nom.* Bigelow-Sanford Carpet Co., 3 Trade Reg. Rep. ¶ 16800, at 21755 (F.T.C. Feb. 10, 1964).
18 *Ibid.*
19 3 Trade Reg. Rep. ¶ 16802 (F.T.C. Feb. 10, 1964).
20 3 Trade Reg. Rep. ¶ 16877 (F.T.C. April 3, 1964).

possesses a high degree of consumer acceptance due to brand advertising or product characteristics and therefore demands a premium price is a factor which should be considered in determining whether there has been a good faith meeting of competition, rather than in determining whether there have been sales of like grade and quality within the meaning of 2(a).[21] Thus, where a seller of a premium-priced product discriminates to meet the price of a seller marketing a popularly priced product, exact price meeting may become undercutting and make the prices suspect with relation to evaluating the defense.

In *Forster Mfg. Co.*,[22] the Commission rejected the seller's 2(b) defense on the ground, among others, that Forster failed to show that, prior to its granting of discriminatory prices, it knew the identity of its competitors and the amount of discounts offered by those competitors to the customers favored by Forster. In the Commission's view, such a requirement was implicit in 2(b) itself and in the statement of the Supreme Court construing that section in the *Staley* case.[23] The Court of Appeals for the First Circuit, however, ruled that the Commission's *foreknowledge requirement* was stricter than the test laid down in *Staley*, and remanded the case to the Commission for a consideration of the evidence in the light of the *Staley* rule.[24] On remand, the Commission again rejected the 2(b) defense.[25] By way of dictum, the Commission stated that they had not intended their original opinion to be interpreted to mean that a seller had to produce "proof positive" as to the identity of competitors and the exact amounts of their price offers. However, the Commission felt that sellers have a duty to make diligent investigations of reported competitive price offers before granting discriminatory prices in order to show good faith.

II. Cost Justification

The cost proviso contained in section 2(a)[26] permits the justification of price differentials stemming from cognizable differences in a seller's costs of dealing with the purchasers paying the higher and lower prices. The topic which has received the most attention in recent opinions of the courts and the Commission involves the standards to be applied in grouping customers for purposes of establishing cost-justifiable pricing categories.

The grouping of customers for purposes of pricing and averaging of costs has been approved by the Supreme Court.[27] The Court took great pains, however, to warn that the line between different customer classes must be drawn with great care:

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21 Gerber Prods. Co. v. Beech-Nut Life Savers, Inc., 160 F. Supp. 916, 919-21 (S.D.N.Y. 1958).

22 3 Trade Reg. Rep. ¶ 16243 (F.T.C. Jan. 3, 1963).

23 FTC v. A. E. Staley Mfg. Co., 324 U.S. 746 (1945).

24 Forster Mfg. Co. v. FTC, 335 F.2d 47 (1st Cir. 1964).

25 Forster Mfg. Co., 3 Trade Reg. Rep. ¶ 17304 (F.T.C. July 29, 1965).

26 The cost justification proviso of § 2(a) states:

> . . . [N]othing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered. . . .

Robinson-Patman Act § 2(a), 49 Stat. 1526 (1936), 15 U.S.C. § 13(a) (1964).

27 United States v. Borden Co., 370 U.S. 460 (1962).

> A balance is struck by the use of classes for cost justification which are composed of members of such selfsameness as to make the averaging of the cost of dealing with the group a valid and reasonable indicium of the cost of dealing with any specific group member. High on the list of "musts" in the use of the average cost of customer groupings under the proviso of § 2(a) is a close resemblance of the individual members of each group on the essential point or points which determine the costs considered.[28]

In the *Borden* case itself, the customer groupings were not shown to have "sufficient homogeneity" in terms of the cost factors considered, and therefore were invalidated by the Court. Borden had attempted to differentiate its costs of doing business with two chain stores on the one hand, and a number of independent grocery stores on the other. However, the record indicated that the cost savings attributed to the chain stores by Borden could also be attributed to some of the independent grocery stores which purchased in volumes comparable to or larger than the chain stores.[29] In addition, it appeared that Borden had assigned certain costs to the independent stores which were not in fact incurred with respect to all of them. In short, the customer groupings set up by Borden were not composed of members possessing the requisite "selfsameness" with respect to the essential point or points determining the costs considered.

In another *Borden* case,[30] Borden charged higher prices to customers purchasing Borden label milk than to those purchasing private label milk. In defense, Borden asserted that the price differentials were cost justified. Borden's cost study compared the nationwide, annual average price differentials per case between Borden label and private label milk. It concluded that the price differentials in favor of the private label purchasers were more than justified by cost savings realized in doing business with that class of purchaser. The Commission rejected the cost study for two fundamental reasons, among others. In the first place, Borden's use of "broad averaging" distorted the measurement of the price differentials to be cost justified. The record indicated that the price differentials which gave rise to competitive injury varied substantially from one area of the country to another; they also varied to a lesser degree within each area from time to time throughout the year.[31] Therefore, the averaging of prices on a nationwide annual basis for purposes of the cost study was not a true reflection of the price differentials at issue, *i.e.*, those causing competitive injury.

Second, the Commission determined that the averaging of costs as to all Borden label customers as a group and as to all private label customers as a group was unacceptable in that it resulted in the grouping together of customers as to which Borden's costs were obviously not substantially the same.[32]

In *American Motors Corp.*,[33] American Motors, a manufacturer of electrical appliances, and its subsidiary sales corporation were charged with violating sec-

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28 *Id.* at 469.
29 *Id.* at 469-70.
30 Borden Co., 3 Trade Reg. Rep. ¶ 16191 (F.T.C. Nov. 28, 1962), *rev'd on other grounds,* 339 F.2d 133 (5th Cir. 1964), *cert. granted,* 382 U.S. 807 (1965).
31 *Id.* at 21024.
32 *Id.* at 21025.
33 3 Trade Reg. Rep. ¶ 17297 (F.T.C. July 19, 1965).

tion 2(a). The price differentials at issue involved sales through the subsidiary corporation to "regular" dealers at prices consistently higher than the prices charged competing retailers designated as "merchandising distributors" on the purchase of electrical appliances of like grade and quality. American Motors asserted that the lower prices to the "merchandising distributors" were based on legitimate cost savings within the meaning of the cost justification proviso. In the Commission's view, the cost justification defense, as presented, was defective since American Motors had failed to meet its threshold burden of establishing a reasonable basis for the classification of its customers.

The unique feature of the *American Motors* decision was the order to cease and desist. Under the terms of that order, American Motors must submit any asserted cost-justified price differentials to the Commission for its approval at least 60 days prior to their effective date. In addition, the order requires American Motors to make the basis for these price differentials known to all of its customers. In the Commission's language, this provision is designed to facilitate the Commission's ascertainment as to "whether a given customer was discriminated against or had simply elected not to avail itself of the opportunity to secure the lower prices."

In conclusion, it may be said that in order to have any real chance of justifying price differentials based upon differences in costs, a seller must be very careful in determining the proper criteria to be used in the classification of its customers; and it must, as a practical matter, do this *in advance* of charging the differing prices. The failure of most post facto cost studies can be traced to a single fundamental handicap — the criteria selected and used for such a purpose, without the careful advance consideration necessary, have failed to reflect accurately the essential factor or factors which determine the particular costs in question. In the words of the cost proviso itself, such criteria have failed to relate to the "differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered."[34]

34 Robinson-Patman Act § 2(a), 49 Stat. 1526 (1936), 15 U.S.C. § 13(a) (1964).